

Audit



Report

OFFICE OF THE INSPECTOR GENERAL

**DISPOSAL OF MUNITIONS LIST ITEMS IN THE
POSSESSION OF DEFENSE CONTRACTORS**

Report No. 97-134

April 22, 1997

Department of Defense

Additional Copies

To obtain additional copies of this audit report, contact the Secondary Reports Distribution Unit of the Analysis, Planning, and Technical Support Directorate at (703) 604-8937 (DSN 664-8937) or FAX (703) 604-8932.

Suggestions for Future Audits

To suggest ideas for or to request future audits, contact the Planning and Coordination Branch of the Analysis, Planning, and Technical Support Directorate at (703) 604-8939 (DSN 664-8939) or FAX (703) 604-8932. Ideas and requests can also be mailed to:

OAIG-AUD (ATTN: APTS Audit Suggestions)
Inspector General, Department of Defense
400 Army Navy Drive (Room 801)
Arlington, Virginia 22202-2884

Defense Hotline

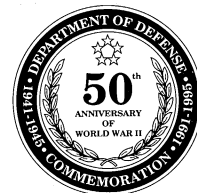
To report fraud, waste, or abuse, contact the Defense Hotline by calling (800) 424-9098; by sending an electronic message to Hotline@DODIG.OSD.MIL; or by writing the Defense Hotline, The Pentagon, Washington, D.C. 20301-1900. The identity of each writer and caller is fully protected.

Acronyms

DCMC	Defense Contract Management Command
DFARS	Defense Federal Acquisition Regulation Supplement
DLA	Defense Logistics Agency
FAR	Federal Acquisition Regulation
FLIS	Federal Logistics Information System
MLI	Munitions List Item
NSN	National Stock Number
PLCO	Plant Clearance Officer



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884



April 22, 1997

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
DEPUTY UNDER SECRETARY OF DEFENSE
(INDUSTRIAL AFFAIRS AND INSTALLATIONS)
DIRECTOR, DEFENSE PROCUREMENT
DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Audit Report on Disposal of Munitions List Items in the Possession of
Defense Contractors (Report No. 97-134)

We are providing this report for review and comment. The audit was requested by the former Director, Defense Logistics Agency. This report is one in a series of reports dealing with the controls over the reutilization, transfer, donation, and sales of munitions list items. Management comments on a draft of this report were considered in preparing the final report.

DoD Directive 7650.3 requires that all internal audit issues be resolved promptly. We request that the Director, Defense Procurement, reconsider her comments to Recommendation A.2. and that the Director, Defense Logistics Agency, reconsider the materiality of the management control weaknesses identified by the audit. We request the Director, Defense Logistics Agency, and the Director, Defense Procurement to provide those additional comments by June 18, 1997. In the interim, we would be happy to meet to discuss the rationale for our recommendations or any management suggestions for alternative measures to address the problems indicated by the audit.

The Under Secretary of Defense (Comptroller) and Deputy Under Secretary of Defense (Industrial Affairs and Installations) have been added to this report as addressees because of their involvement in an on-going DoD review of overall management of Government-owned property in the hands of contractors.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. James L. Kornides, Audit Program Director, or Mr. Stuart D. Dunnett, Audit Project Manager at (614) 751-1400. See Appendix G for the report distribution. The audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 97-134
(Project 5FJ-5024.02)

April 22, 1997

Disposal of Munitions List Items in the Possession of Defense Contractors

Executive Summary

Introduction. This is the third in a series of reports resulting from our audit of the Controls Over the Reutilization, Transfer, Donation, and Sale of Munitions List Items (Project No. 5FJ-5024). The former Director, Defense Logistics Agency, requested the audit because of concern that munitions list items might be released outside DoD without proper controls. Appendix B summarizes the first two reports, which concern Navy management of the transfer of reclaimable aircraft to museums and Army controls over the disposition of excess helicopters and parts. The fourth report addresses munitions list coding. A fifth report is in draft regarding exchange transactions at the U.S. Center for Military History involving munitions list items.

Munitions list items are military articles that require special handling at disposal to prevent their unauthorized use by domestic or foreign purchasers. The items can range from major weapon systems (tanks) to key components (spring mechanisms in firearms) of weapon systems. The Defense Contract Management Command, a subordinate command of the Defense Logistics Agency, is responsible for ensuring that Defense contractors comply with applicable DoD demilitarization policies when disposing of munitions list items. As of September 30, 1995, the 15 contractors we reviewed in our sample held Government property valued at about \$9.9 billion and disposed of \$114.6 million of Government property during the year.

Audit Objectives. The overall audit objective was to evaluate whether the Defense Reutilization and Marketing Service and the Defense Contract Management Command were appropriately reutilizing, transferring, donating, and selling munitions list items. For this part of the audit, we determined whether DoD acquisition and disposal officials and Defense contractor personnel were identifying munitions list items that Defense contractors possessed and were adequately monitoring whether the contractors properly disposed of the items. We also evaluated applicable management controls of the Defense Logistics Agency as they related to the audit objectives.

Audit Results. Improvements were needed in the identification and disposal of munitions list items in the possession of contractors. At the 15 contractor locations we visited, DoD and Defense contractor personnel generally did not identify whether items used by contractors to develop and field weapon systems were munitions list items. Of the 1,820 items we judgmentally sampled, 1,400 were not reviewed and categorized.

As a result, when the property was no longer needed, the Defense Contract Management Command directed Defense contractors to sell it, without knowing whether any of it required strict controls to keep it from unauthorized recipients (Finding A).

The Defense Contract Management Command did not adequately monitor the disposal of 155 items that DoD personnel identified as munitions list items. As a result, the items were sold without application of the required trade security and demilitarization procedures (Finding B).

Improvements in the identification and monitoring of sensitive items used in the production of weapon systems are needed as an anti-terrorism measure. Implementing the report recommendations will improve controls over identifying and disposing of munitions list items in the possession of Defense contractors. See Appendix A for a discussion of our review of the management control program and the material control weaknesses identified by the audit.

Summary of Recommendations. We recommend that the Director, Defense Logistics Agency, establish a working group with members from the offices of Component Acquisition Executives to establish policies to assist DoD personnel and Defense contractors in identifying and controlling munitions list items acquired by Defense contractors, but not assigned national stock numbers. We also recommend that the Defense Logistics Agency modify the existing demilitarization training program within DoD to provide clear instruction to plant clearance officers for the identification and control of munitions list items in the possession of Defense contractors. We recommend that the Director, Defense Procurement implement a change to the DoD Federal Acquisition Regulation Supplement that requires Defense contractors to provide assistance in identifying munitions list items early in the acquisition cycle and modify the proposed change accordingly. We recommend that the Director, Defense Contract Management Command, emphasize to Defense contractors the requirement to furnish national stock numbers for items on inventory schedules, when numbers are available, and use automated processes and DoD data bases to the fullest extent possible to identify items with national stock numbers.

Management Comments. The Director, Defense Logistics Agency, agreed with the need for improvements and with the intent of the recommendations made to the Defense Contract Management Command, although he disagreed with the materiality of the control weaknesses and with some of the reasons cited for the problems. The Defense Contract Management Command undertook several corrective actions. The Director, Defense Procurement, nonconcurred with our recommendation to revise the proposed change to the DoD Federal Acquisition Regulation Supplement to require Defense contractors to identify munitions list items at the earliest possible time. The Director stated that requiring Defense contractors to evaluate each item on every contract at the earliest point in time is neither practical nor cost effective. See Part I for a summary of management comments and Part III for a complete text of management comments.

Audit Response. The improvements initiated by the Defense Logistics Agency met the intent of our recommendations but the comments regarding the materiality of the control weaknesses were not responsive. We also disagree with the comments provided by the Director, Defense Procurement. We continue to believe that munitions list items should be identified at the earliest time, usually when the technical expertise needed to identify items as munitions list items is available from a contractor. We request that the Director, Defense Logistics Agency, and Director, Defense Procurement, provide additional comments to the findings and recommendations by June 18, 1997.

Table of Contents

Executive Summary	i
--------------------------	---

Part I - Audit Results

Audit Background	2
Audit Objectives	3
Finding A. Identification and Controls Over Surplus Munitions List Items Not Assigned National Stock Numbers	4
Finding B. Disposal of Munitions Lists Items With National Stock Numbers	14

Part II - Additional Information

Appendix A. Audit Process	
Audit Scope	24
Audit Methodology	24
Audit Period and Standards	25
Organizations and Individuals Visited or Contacted	25
Management Control Program	25
Appendix B. Prior Audits and Other Reviews	27
Appendix C. Demilitarization Codes	29
Appendix D. United States Munitions List Items	30
Appendix E. Proposed Modification to Defense Federal Acquisition Regulation Supplement	31
Appendix F. Sample Munitions List Items With Assigned National Stock Numbers	32
Appendix G. Report Distribution	36

Part III - Management Comments

Director, Defense Procurement, Comments	40
Defense Logistics Agency Comments	43

Part I - Audit Results

Audit Background

This is the third in a series of reports resulting from our audit of the Controls Over the Reutilization, Transfer, Donation, and Sale of Munitions List Items (Project No. 5FJ-5024). The audit of munitions list items (MLIs) was requested by the former Director, Defense Logistics Agency. He was concerned that MLIs might be released outside DoD without proper controls. Appendix B summarizes the first two reports, which concern Navy management of the transfer of reclaimable aircraft to museums and Army controls over the disposition of excess helicopters and parts. The fourth report concerns munitions list coding. A fifth report is in draft regarding exchange transactions at the U.S. Center for Military History involving munitions list items.

MLIs are military articles that require special handling at disposal to prevent their unauthorized use by domestic or foreign customers who buy surplus items. MLIs can range from major weapon systems (tanks) to key components (spring mechanisms in firearms) of the related weapon systems.

MLIs in the possession of Defense contractors are controlled at disposal by implementing demilitarization or trade security controls. Demilitarization controls are intended to destroy or render useless the military characteristics of certain types of MLIs, while trade security controls are designed to reduce the possibility of illegal exports of MLIs. The main distinction between the two types of control is that demilitarization prevents the unauthorized use of military hardware or technical data, while trade security controls prevent the unauthorized export of MLIs not requiring demilitarization.

Military Department acquisition or logistics organizations establish demilitarization controls when assigning a national stock number (NSN) to an inventory item. Those organizations use demilitarization codes to identify whether an inventory item should be classified as an MLI and to convey the corresponding level of control required at disposal. Appendix C provides a list of the demilitarization codes.

The Defense Contract Management Command (DCMC), a subordinate command of the Defense Logistics Agency, is responsible for ensuring that Defense contractors comply with applicable DoD demilitarization policies when disposing of MLIs.

As of September 30, 1995, the DCMC administered about 14,630 contracts. Government property associated with those contracts was valued at about \$68 billion. As of September 30, 1995, the 15 contractors we reviewed held Government property valued at about \$9.9 billion and disposed of \$114.6 million of Government property during the year, including MLIs. We could not quantify the value of excess MLIs because the DCMC property system did not track that data.

Audit Objectives

The overall audit objective was to evaluate whether the Defense Reutilization and Marketing Service and the Defense Contract Management Command were appropriately reutilizing, transferring, donating, and selling munitions list items. For this part of the audit, we determined whether DoD acquisition and disposal personnel and Defense contractor personnel were identifying munitions list items that Defense contractors possessed and were adequately monitoring whether the contractors properly disposed of the items. We also evaluated applicable management controls for the Defense Logistics Agency as they related to the audit objectives.

Finding A. Identification and Controls Over Surplus Munitions List Items Not Assigned National Stock Numbers

At the 15 contractor locations visited, DoD officials and Defense contractor personnel generally did not identify whether items used by contractors to develop and field weapon systems were MLIs. Of the 1,820 items sampled, 1,400 had not been reviewed or categorized as MLI or non-MLI. The sample items included components, test equipment, and special tooling for weapon systems. DoD and contractor personnel did not consider whether the items were MLIs because:

- o policies and procedures were not in place to assist DoD and contractor personnel in identifying MLIs when they had no NSNs, and

- o contracts did not require Defense contractors to assist DoD personnel in identifying MLIs not assigned NSNs.

Additionally, the DCMC proposal to modify the Defense Federal Acquisition Regulation Supplement needed supplementation to assign responsibility for identifying MLIs during the acquisition cycle and to address contractor-owned and lost property.

As a result, when items were no longer needed, the DCMC directed Defense contractors to sell them, without knowing whether the items required demilitarization or trade security controls. Improved controls are needed as an anti-terrorism and general security measure.

Items Used to Develop and Field Weapons Systems

DoD contractors make or buy significant quantities of raw materials, sub-assemblies and components, special tooling, special test equipment, and industrial plant equipment needed to manufacture, upgrade, and maintain DoD weapon systems. Government-owned property falling into those categories is generally classified as "contractor-acquired property."

Contractor-acquired property, especially special tooling and test equipment, is used for a specific purpose and is unique to a particular weapon system. Once DoD declares contractor-acquired property as surplus, little reutilization demand exists for it from qualified DoD recipients or state and local governments. In general, surplus contractor-acquired property is sold to the public for its basic material contents.

Although assigning an NSN is the first step in identifying items needing demilitarization codes, contractor-acquired property is generally not assigned an NSN. To illustrate, as of September 30, 1995, a Defense contractor had about

Finding A. Identification and Controls Over Surplus Munitions List Items Not Assigned National Stock Numbers

74,000 Government-owned special tools on record with no assigned NSNs. The special tooling was used to support the Defense contractor's aircraft and missile programs.

DoD property at contractor sites was not assigned an NSN for one or more of the following reasons.

- o Key components or tooling (special tooling or test equipment manufactured by Defense contractors for their specific DoD weapon systems) were not procured in sufficient quantities to justify assigning an NSN.

- o DoD procurement organizations relied on Defense contractors for life-cycle logistics support for manufacturing, updating, or maintaining selected weapon systems (for example, the Tomahawk Cruise Missile) and, therefore, had no need to assign an NSN because the items would not be stocked in the DoD inventory.

- o Raw material or key subassemblies (electronic components used to assemble classified computerized weapon systems) were procured directly by Defense contractors from non-DoD subcontractors.

Identification of Munitions List Items

When disposing of surplus items that had been used by Defense contractors to develop and field weapon systems, DoD and Defense contractor personnel did not identify which of the surplus items were MLIs.

We judgmentally sampled 1,820 surplus Government-furnished and contractor-acquired items that were sold at the 15 Defense contractor facilities visited. The surplus items were formerly related to the specific defense weapon system (key components or spare parts) being manufactured or were used in the production and fielding of defense weapons systems. The 15 Defense contractors concluded the items were no longer needed and forwarded them to DCMC on plant clearance inventory schedules.

Although surplus items related to Defense weapon systems may require special handling upon disposal, DoD and contractor personnel did not do an analysis to determine whether 1,400 of the 1,820 surplus items were MLIs. We did not determine whether the 1,400 surplus were MLIs as part of this review. The remaining 420 items were identified and assigned a demilitarization code.

Policies and Procedures

Defense Federal Acquisition Regulation Supplement (DFARS) 252.245, "Government Property", January 1, 1995, and DoD 4160.21-M-1, "Defense

Finding A. Identification and Controls Over Surplus Munitions List Items Not Assigned National Stock Numbers

Demilitarization Manual," October 1991, do not adequately explain how to dispose of MLIs that are not assigned an NSN. Adequate control over MLIs during the disposal process ensures that national security interests are protected.

Procedures in the DFARS related to Defense contractor responsibilities for identifying and disposing of MLIs do not include procedures for disposing of items without an NSN. Also, the policy on demilitarization as stated in DoD 4160.21-M-1 generally applied only to those weapon system end items and related key components that had an NSN, were declared surplus by the responsible item managers, and were subsequently sent to Defense Reutilization and Marketing Offices at DoD military installations worldwide. In addition, DoD 4160.21-M-1 makes little provision for the treatment of the items that were reported as surplus by Defense contractors but not assigned an NSN.

DoD Requirements to Identify MLIs on Contracts

Procurement contracting officers in program offices and buying commands did not generally incorporate DoD requirements to identify and control MLIs in major weapon system contracts. The 15 DoD contractors visited produced major weapon systems, such as the F-16 and F-22 aircraft, AH-64 helicopter, Bradley Fighting Vehicle, M1A1 Abrams Tank, M242 cannon, and Tomahawk Cruise and Advanced Medium Range Air to Air Missiles.

Defense contractor personnel interviewed were generally unfamiliar with the applicable DoD demilitarization and disposal policies. They stated that requirements for them to classify contractor-acquired property as an MLI or non-MLI and to assign appropriate demilitarization codes were not specifically incorporated into their respective contracts and, therefore, were not binding. When a contract clause covering disposal procedures was included, Defense contractors were required to perform the special handling requirements. For example, the Armament and Chemical Acquisition and Logistics Activity in Rock Island, Illinois, required all contracts for small arms (less than 40 millimeter) to include clauses covering disposal of surplus material, tooling, and technical data. The clauses required small arms contractors to demilitarize all surplus small arms parts and sensitive technical data to minimize the risk of improper release of those items.

DCMC Proposed Disposal Policies

The Office of the Under Secretary of Defense for Acquisition and Technology tasked the Government Property and Plant Clearance Committee, chaired by DCMC, to review all proposed changes to the Federal Acquisition Regulation and the DFARS related to Government property. The Government Property and Plant Clearance Committee has reviewed and submitted to the Defense Acquisition Regulations Council (the Council), a proposal (Case 92-D024,

Finding A. Identification and Controls Over Surplus Munitions List Items Not Assigned National Stock Numbers

Demilitarization) to modify DFARS 252.245. The referenced section requires Defense contractors to provide an annual report on all DoD property for which they were accountable under applicable contracts.

However, the section is silent regarding Defense contractor responsibilities for identifying and classifying surplus MLIs and assigning the appropriate level of demilitarization at the time of disposal.

Initial Proposal. An earlier proposal that was approved by the Council and published in the March 23, 1995, Federal Register was rescinded because of the adverse comments from Defense contractors. The initial proposal would have required Defense contractors to identify the demilitarization code for all excess Government-owned property reported on inventory schedules or transferred to a follow-on contract. Defense contractors objected to the proposal because the conclusion that only excess items require control is not valid. In addition, Defense contractors believed that DoD did not fully understand the proposed requirement because demilitarization codes can change throughout the manufacturing process.

Current Proposal. A new revision was sent to the Council on January 23, 1996. If approved and incorporated into the DFARS, the revision would require Defense contractors to identify surplus items as either an MLI or non-MLI. For those items determined to be MLIs, the Defense contractor would be required to assign the appropriate demilitarization code before submitting the list of surplus items to the DCMC plant clearance officer (PLCO) for disposal instructions. In addition, the revised clause includes language that:

- o permits Defense contractors to be paid for demilitarization of surplus Government property,

- o incorporates into the DFARS the demilitarization and trade security control sales terms and conditions from the Defense Demilitarization Manual, and

- o references the specific chapter and paragraph of the Defense Demilitarization Manual that provide the appropriate method of demilitarization.

We agree with the basic intent of the proposed change to the DFARS that will require Defense contractors to become contractually involved with the classification and subsequent need to demilitarize selected MLIs.

However, we disagree with the point in time when the classification and assignment of an appropriate demilitarization code is to be performed. Specifically, the proposal allows the contractor to delay classifying items as MLIs and assigning appropriate demilitarization codes until disposal actions are initiated rather than when contractor-acquired property is purchased or manufactured in-house.

Appropriately Identifying MLIs. Defense contractors should not delay classifying items as MLIs until the items are ready for disposal. According to DoD 4160.21-M-1, the best time to identify MLIs and to determine the

Finding A. Identification and Controls Over Surplus Munitions List Items Not Assigned National Stock Numbers

appropriate demilitarization control technique is early in the acquisition process. At that time, individuals have access to the technical data needed to identify key weapon system parts, components, accessories, and the technology essential to weapon system production to determine whether items:

- o were specifically designed, developed, configured, adapted, or modified for a military application;
- o had significant military or intelligence applicability; or
- o had no predominant civil application or performance equivalent.

In considering the above information at the time of the acquisition or manufacturing process, demilitarization control techniques would be easier to identify because of the availability of technical documents and the engineers who are involved in developing the end item. To delay determining appropriate demilitarization control techniques until the items are declared surplus many years later would only increase the cost of disposal by increasing the work needed to ensure national security is not compromised.

For example, during FY 1995, the cognizant PLCO instructed a Defense contractor to demilitarize about 10,000 pieces of surplus contractor-acquired special tooling and test equipment. The equipment had not been assigned NSNs. To dispose of the surplus property, a technician at the weapon system program office assigned the demilitarization codes thought to be appropriate. The property, which had been accumulated over a 10- to 15-year period, was related to the production of several military aircraft. The Defense contractor informed the PLCO that it would cost about \$9.0 million to perform the desired demilitarization. After receiving the cost estimate, DCMC personnel requested that the technician reevaluate the assigned demilitarization codes and identify only those items that had significant military or intelligence applicability. The technician at the weapon system program office subsequently submitted a revised list that greatly reduced the amount of Government property needing to be demilitarized. Because of the reduced number (about 200) of items requiring demilitarization, the Defense contractor agreed to demilitarize the items at no cost to the Government. Had the demilitarization codes been assigned at the time the property was manufactured or purchased by the Defense contractor, the entire process would have been avoided.

Although we believe that the Director, Defense Procurement, should implement a change to the proposed DFARS 252.245-7XXX clause for future DoD contracts that advances the identification of MLIs to the early stages of the acquisition process, we do not want to delay release of the current proposed change for comment in DoD. The Director Defense Procurement should consider our finding and recommendation along with other comments to the proposed DFARS revision. Appendix E contains our suggested wording.

Other Property. The proposed change to the DFARS would not cover all MLIs in the possession of Defense contractors. The proposed policy does not address contractor-owned and lost property that meets the definition of MLIs requiring special handling instructions at disposal.

Finding A. Identification and Controls Over Surplus Munitions List Items Not Assigned National Stock Numbers

Contractor-Owned Property. The proposed change to the DFARS does not discuss contractor-owned property. In the past, Defense contractors acquired and disposed of large quantities of material and tooling for DoD weapon systems produced under fixed-price contracts and under contracts with foreign governments. Surplus material, including scrap from those contracts, was not processed through DCMC PLCOs and would not be covered by the proposed DCMC policies. In our opinion, all property in the possession of Defense contractors, regardless of ownership, should be adequately controlled if the property falls within the DoD 4160.21-M-1 definition of MLIs.

Lost Property. The proposed change to the DFARS also does not discuss lost property. Government-owned property lost by Defense contractors was reported to DCMC property personnel on separate disposal inventory lists. For example, one Defense contractor we visited reported losses of Government-owned property of about \$1.6 million during FY 1995. We reviewed the 22 of the lost items that had NSNs and determined that 15 of the 22 were MLIs. However, current or proposed DCMC policies have no provisions that require the DCMC to determine whether lost items were MLIs.

Sale of Items Related to Major DoD Weapon Systems

The DCMC directed Defense contractors to sell items related to major DoD weapon systems without the required demilitarization or other controls that would keep the items from unauthorized recipients. All the excess items in our sample were sold to the public without DoD or contractor personnel determining whether demilitarization controls were needed. Application of the controls would ensure that the property was rendered harmless or useless for "reverse engineering" purposes.

Anti-Terrorism Measures

On July 15, 1996, the Secretary of Defense issued Anti-Terrorism Readiness Sustaining Measures that require revision to the DFARS. The measures call for DoD contractors to improve their anti-terrorism readiness activities.

Keeping critical Defense materials from terrorists through demilitarization and trade security controls is in accordance with the actions proposed by the Secretary of Defense. The surplus items disposed of by contractors were not being reviewed to determine their suitability for release, and those items could contain MLIs that could fall into the hands of hostile groups or countries.

Finding A. Identification and Controls Over Surplus Munitions List Items Not Assigned National Stock Numbers

Conclusion

Items used in the production of weapon systems not assigned NSNs were not reviewed before disposal to determine whether the items were MLIs. The policies needed to ensure that DoD and Defense contractor personnel identified items as MLIs and controlled them appropriately were lacking. Improved controls would ensure that MLIs are identified and controlled at all stages of a Defense contractor's production and maintenance process. The improved controls should not place an undue burden on the contractor. The use of selected control techniques would ensure that Defense contractors are not forced to assign demilitarization codes to each item acquired or require that contractor property control systems be modified. Additionally, Defense contractors should be required to assist DoD in identifying MLIs and in recommending an appropriate control technique. Specific Defense contractor responsibilities should be included in the DFARS and DoD 4160.21-M-1 and be incorporated into future DoD systems production and maintenance contracts.

During the audit, DoD management identified the issue of accountability over Government-owned property in the possession of contractors as an area of concern, and an Integrated Process Team was established to study the overarching issues involved. We added the Under Secretary of Defense (Comptroller) and Deputy Under Secretary of Defense (Industrial Affairs and Installations) to this report as addressees because of their involvement in the ongoing DoD review

Management Comments on the Finding and Audit Response

Management Comments. The Director, Defense Logistics Agency (DLA), partially concurred with the finding and agreed that DCMC PLCOs were not adequately reviewing excess items to determine whether they qualified as munitions list items. However, the Director did not agree that policies and procedures were not in place to assist DoD personnel in identifying munitions list items not assigned NSNs. The Director stated the problem of not receiving assistance from Defense contractors in identifying excess munitions list items would be corrected by the implementation of the DFARS policy change. This change will require Defense contractors to identify munitions list items prior to disposal. In addition, the Director stated that improved demilitarization controls were needed and that plans for wider use of the Federal Logistics Information System and enhancements to training programs had already been introduced or were being developed. The Director also nonconcurred with the management control weakness discussed in Appendix A related to identifying munitions list items.

Audit Response. We disagree with the Director's comments. We agree with the intent of the planned actions the Director has chosen to strengthen controls over the identification of munitions list items. Contractors should assist DoD in identifying MLIs. However, we do not agree that Defense contractors should

Finding A. Identification and Controls Over Surplus Munitions List Items Not Assigned National Stock Numbers

delay identifying munitions list items until the time of disposal as allowed by the DFARS policy change. The Director's comments imply that if PLCOs would have followed the disposal policies in place, munitions list items would be appropriately identified. However, DCMC policies required PLCOs to perform duties above their level of expertise, to request that Defense contractors provide information they were not obligated to provide, and to request assistance from other DoD sources that also lacked the necessary expertise to identify munitions list items. In addition, the existence of proposed changes to the DFARS and DoD 4160.21-M-1 contradicts the Director's comments that policies and procedures were adequate.

As shown by our sample, most excess Government property from Defense contractor plants is not assigned an NSN. Reviewing these items in a timely manner to determine whether or not they are munitions list items requires coordination above the PLCO level. This principle is reflected in the proposed DFARS change that specifically requires contractors to assist in identifying munitions list items.

We agree in principle with the policy changes DLA is proposing. However, procedures in place at the time of the audit were not adequate to ensure that a review was performed to identify munitions list items not assigned NSNs.

We believe the management control weakness identified is material. The weakness matches the materiality criteria of DoD Directive 5010.38, Management Control Program, August 26, 1996. Specifically, the absence of reviews of items in the possession of contractor that are munitions list items significantly weakens the safeguards against fraud, waste or mismanagement of property. The material weakness exists because a review of all munitions list items has never been made, and proposed policy changes have not been fully implemented. When these actions occur, DLA will be in position to test whether all munitions list items are appropriately identified. We request that the Director reconsider the nonconcurrency related to the material control weakness identified in Appendix A and provide additional comments to the final report.

Recommendations, Management Comments, and Audit Responses

A.1. We recommend that the Director, Defense Logistics Agency, establish a working group with members from the offices of the Component Acquisition Executives to establish policies in DoD 4160.21-M-1, "Defense Demilitarization Manual," October 1991, that assist DoD and Defense contractors in identifying and controlling munitions list items that are acquired by Defense contractors but are not assigned national stock numbers.

Finding A. Identification and Controls Over Surplus Munitions List Items Not Assigned National Stock Numbers

Management Comments. The Director partially concurred, stating that the changes to DoD 4160.21-M-1 that will assist contractors in controlling munitions list items/strategic list items have already been drafted and will be included in the 1997 rewrite. He indicated that the new language was formulated by the DoD Demilitarization Program Manager and the DLA Materiel Management Disposal Program Team, in conjunction with Defense Contract Management Command Headquarters, and was coordinated with the DoD Demilitarization Policy Working Group. He also stated that a proposed revision has been made to the DFARS that assigns contractors the responsibility for identification and control of munitions list items not assigned national stock numbers. The additional policies that have been proposed for the FAR require contractors to maintain NSNs for all items of Government property in their possession and to report demilitarization codes when the property is reported excess. He indicated these policy revisions should improve the control and identification of munitions list items.

Audit Response. The DLA actions meet the intent of this recommendation. Coordination of the policy changes through the DoD Demilitarization Policy Working Group provides the policy development and review we envisioned. No further comments are required.

A.2. We recommend that the Director, Defense Procurement, Office of the Under Secretary of Defense for Acquisition and Technology, implement a change to the proposed DFARS section 252.245-7XXX clause for future DoD contracts. See Appendix E for suggested wording.

- o The clause should require that when Government property is required to perform a contract, the contractor shall coordinate with the appropriate DoD officials in the DoD Demilitarization Program Office to assist in identifying munitions list items at the earliest point in time and to identify the appropriate level of control required during the production and disposal of each item.

- o The clause should also discuss contractor-owned and lost property that meets the definition of munitions list items that require special handling instructions at disposal.

Management Comments. The Director, Defense Procurement, nonconcurred with the recommendation, stating that the DoD Demilitarization Program Office is not capable of adequately assisting Defense contractors in identifying munitions list items early in the acquisition process and that a Defense contractor's point of contact should be its local contract administration office. The Director also stated that requiring Defense contractors to evaluate each item manufactured or acquired under every Governmental contract at the earliest point in time is neither practical nor cost effective. In addition, the Director noted that there has been no evidence of extensive unauthorized use of munitions list items during the contract performance process and that requirements for the disposition of contractor-owned property are outside the scope of the DFARS clause.

Finding A. Identification and Controls Over Surplus Munitions List Items Not Assigned National Stock Numbers

Audit Response. We disagree that the DoD Demilitarization Program Office is not capable of adequately assisting Defense contractors in identifying munitions list items. The personnel in that office have the training and experience needed to make the necessary demilitarization decisions. Although it was not a routine part of their job, we observed Demilitarization Program Office personnel meeting with contractors on the classification of items (the special tooling and test equipment on page 10 of this report was one example) and they indicated they were capable of and interested in assisting contractors to identify munitions list items early in the life cycle of weapon systems.

We realize that some additional cost may be incurred in identifying munitions list items at the earliest identifiable time in the production process. However, contractors ought to know which items in their facilities are MLI. We believe any cost incurred early on will be offset later because technical personnel would not be needed at the time of disposal to determine whether each excess item is a munitions list item. Identifying munitions list items as early as possible will be more efficient because technical personnel responsible for procuring defense equipment and material may not be available at the time of disposal. In addition, as we reported, personnel at DCMC offices did not have the expertise required to appropriately identify munitions list items or approve contractor-assigned demilitarization codes.

DoD Demilitarization Program Office personnel should be involved in approving the demilitarization codes that Defense contractors assign to the munitions list items that are not assigned an NSN. The DoD Demilitarization Program Office has responsibility for implementing the demilitarization program and could provide assistance to plant clearance offices in approving demilitarization codes assigned by Defense contractors. Getting Demilitarization Office personnel involved early in the procurement cycle, in determining whether Government property procured by Defense contractors should be classified as munitions list items, is critical. This will ensure that the coding effort is appropriately and consistently performed by Defense contractors and that the coding is approved by DoD personnel with the necessary expertise. This should also prevent the coding inconsistencies that occur between different contractors and would establish a process by which DoD personnel expeditiously review and accept the contractor-assigned demilitarization code.

We continue to believe that contractor-owned property meeting the definition of munitions list items should be identified and controlled early in the acquisition process. Defense contractors should be made aware of the disposal requirements of property meeting the definition of a munition list item within DoD and the requirements of United States Code, title 18, chapter 37, section 793, "Gathering, Transmitting, or Losing Defense Information." We do not consider this a burden on contractors that outweighs the risk of items being released without adequate control.

As previously indicated, although we advocate a change to the proposed DFARS 252.245-7XXX clause for future DoD contracts that advances the identification of MLIs to the early stages of the acquisition process, we do not

Finding A. Identification and Controls Over Surplus Munitions List Items Not Assigned National Stock Numbers

want to delay release of the proposed change for comment in DoD. The Director, Defense Procurement, consider our finding, recommendation, and the suggested wording in Appendix E in concert with the other comments likely to be received on the proposed DFARS revision after it is issued.

In response to this report, we request that the Director, Defense Procurement, reconsider her position and provide additional comments.

Finding B. Disposal of Munitions List Items With National Stock Numbers

The Defense Contract Management Command did not adequately monitor the disposal of 155 items that DoD personnel identified as MLIs at the 15 contractor locations visited. The MLIs were not adequately monitored because:

- o Defense contractors were not required to furnish NSNs, even though they were available;
- o the DCMC did not use available automated data bases to retrieve demilitarization codes, and
- o DoD demilitarization training was ineffective.

As a result, the 155 items were sold without application of the required trade security or demilitarization controls.

Disposal Policies

The various categories of MLIs require different levels of control. Some MLIs require controls under the provisions of the International Traffic in Arms Regulation, while other MLIs are controlled in accordance with the Defense Demilitarization Manual. DCMC disposal policy implements procedures in accordance with the Code of Federal Regulations, title 22, "International Traffic in Arms Regulation," and DoD 4160.21-M-1, "Defense Demilitarization Manual," October 1991.

International Traffic in Arms Regulation. This regulation defines MLIs and provides legal authority for establishing trade security (export) controls. MLIs requiring only trade security controls are designated with demilitarization code B. The demilitarization codes are defined in Appendix C.

Defense Demilitarization Manual. DoD 4160.21-M-1 provides policies and procedures for classifying DoD weapon system end items (for example, tanks) and related key components (for example, engines) as MLIs and for selecting the appropriate level of demilitarization controls. Demilitarization controls require that MLIs with significant military application be rendered useless for their intended purpose at the time of disposal.

DCMC Disposal Policies. Defense Logistics Agency (DLA) Directive 5000.4, "Contract Management," January 1996, provides policies that the DCMC property administrator and the PLCO must follow in monitoring Defense contractors' disposals of surplus Government property. Specifically, DCMC PLCOs must identify the MLIs reported by Defense contractors as surplus and

Finding B. Disposal of Munitions List Items With National Stock Numbers

determine the degree of demilitarization required at the time of disposal. In addition, the PLCO uses information provided by the contractors to:

- o verify the quantity, condition, description, and special processing requirements of the property;
- o screen property and determine the best disposal method for items not screened;
- o provide the contractor with disposition instructions; and
- o prepare and maintain plant clearance records and disposal documents.

Identifying MLIs with National Stock Numbers

DCMC property personnel did not adequately monitor the disposal of items that DoD personnel identified as MLIs. We judgmentally sampled 1,820 items that were on the plant clearance disposal list at 15 Defense contractor facilities. The items, which were once used in the manufacture and fielding of weapon systems, were no longer needed and were eventually sold as usable or scrap property. This sample showed that 420 of the 1,820 items sampled were assigned NSNs and demilitarization codes. Of the items assigned NSNs, 265 were not identified as MLIs (demilitarization code A). In contrast, 155 of the 420 sample items with NSNs were identified as MLIs (see Appendix F). However, DCMC property personnel did not follow appropriate MLI disposal procedures for the 155 sampled items that required controls.

MLI Items. Of the surplus sample items from 10 of the 15 contractors visited, 155 required some type of control under the International Traffic in Arms Regulation and DoD 4160.21-M-1. Specifically, at 10 contractor locations, 111 of the 155 sampled items identified as MLIs required trade security controls, while 44 of the 155 sampled items identified as MLIs required demilitarization controls.

Trade Security Controls. The DCMC PLCOs directed Defense contractors to sell 111 of the 155 items without first applying the required trade security controls (demilitarization code B). The International Traffic in Arms Regulation outlines the trade security controls required to prevent unauthorized exports. DoD is responsible for establishing trade security controls that will reduce the likelihood of illegal exports.

Demilitarization Controls. The DCMC PLCOs directed Defense contractors to sell 44 of the 155 items without first applying the appropriate demilitarization techniques. Demilitarization controls require that items that have significant military utility, capacity, or technology be destroyed or rendered harmless before disposal to prevent their unauthorized use.

Finding B. Disposal of Munitions List Items With National Stock Numbers

Examples of items improperly sold by Defense contractors and requiring varying degrees of demilitarization are listed in the table below. (See Appendix F for a complete listing of MLIs requiring some level of control.)

MLIs Sold Without Proper Demilitarization (See Appendix F for the Complete List)

<u>NSN</u>	<u>Item</u>	<u>Code*</u>
2840-01-227-0377	Rotor, Turbine, Aircraft	C
1005-01-211-4165	Gun Control Box	C
5826-01-183-5499	Radio, Magnetic, Indicator	D

*Demilitarization codes are defined in Appendix C.

Furnishing National Stock Numbers

Federal Acquisition Regulation (FAR) 45.606-5(d)(2), "Inventory Schedules," requires Defense contractors to provide readily available NSNs when contractors prepare inventory schedules of surplus Government-owned property being processed for disposal. The assigned demilitarization code is a mandatory data element that has to be determined before an item can be assigned an NSN and entered into the Federal Logistics Information System (FLIS). In some cases, contractor-acquired property and Government-furnished property were assigned an NSN and an appropriate demilitarization code during the production cycle. Contractor-acquired property and Government-furnished property include raw materials, subcomponents, special tooling and test equipment, and industrial plant equipment used to produce DoD weapon system end items and related components. When an item listed on a surplus property inventory schedule has an assigned NSN, the PLCO can look up the item's demilitarization code in the FLIS and readily determine the required disposal action.

The 15 contractors visited generally were not providing NSNs as required. Of the 1,820 sample items, 420 items had NSNs that could be identified by using the FLIS. However, in preparing the inventory list of surplus items for disposal, the 15 Defense contractors provided only 88 of the 420 NSNs. Two Defense contractors provided 63 of the 88 NSNs by utilizing DoD supply system based software packages. Defense contractors frequently did not provide NSNs because the DCMC PLCOs were not enforcing the provisions in the Federal Acquisition Regulation that require contractors to provide NSNs when available. The DCMC needs to reemphasize the requirement to the PLCOs and to verify that the contractors are complying with the requirements.

Finding B. Disposal of Munitions List Items With National Stock Numbers

Automated Support

DCMC PLCOs are required to use the FLIS data base to obtain demilitarization codes for items reported on the inventory schedules. However, only 2 of the 15 PLCOs we talked to attempted to research the FLIS or use other available computer support to identify demilitarization codes. The other 13 PLCOs said that they neither checked items for NSNs nor identified demilitarization codes because it was too time consuming. We agree that manually researching each item on the inventory schedule would be tedious. However, automated matching of the FLIS information to information in each contractor's inventory system would eliminate the tedious process of manually researching part numbers to obtain a demilitarization code.

DCMC Initiatives. DCMC began work on the Plant Clearance Automated Reutilization Screening System in 1990 to automate plant clearance functions that are now done manually. The system is intended to provide an automated method to identify items with NSNs and to obtain demilitarization codes. When implemented, Defense contractor inventory schedules should be electronically transmitted to the Defense Logistics Supply Center to interface with the FLIS to extract NSNs and demilitarization codes. Although a variety of problems have prevented DCMC from implementing the system, DCMC expects it to be operational in May 1997.

Demilitarization Training

Demilitarization training was not effective for DCMC property personnel. DoD recognized the need to train DoD personnel in identifying and controlling MLIs and had the Army Logistics Management College develop a course on demilitarization. Although all of the PLCOs we talked with attended the course, most were confused after the training about their specific disposal responsibilities. The PLCOs believed that the course was tailored more for inventory managers and Defense Reutilization and Marketing Service personnel and that the course only briefly covered property in possession of Defense contractors.

Conclusion

The DCMC did not adequately monitor the disposal of 155 MLIs at the 15 contractor locations visited. The items had been used to develop and field DoD weapon systems. As a result, the 155 MLIs were sold without the required trade security or demilitarization controls designed to prevent unauthorized exports of sensitive property and to remove military capabilities.

Finding B. Disposal of Munitions List Items With National Stock Numbers

PLCOs did not require contractors to comply with FAR 45.606-5(d)(2), which requires contractors to provide available NSNs for excess MLIs or to use DoD data bases to retrieve demilitarization codes. The DCMC initiated an effort to automate the plant clearance process in 1990; however, the system is not expected to be operational until May 1997. Although computer technology would speed up the process of retrieving demilitarization codes, improved demilitarization training would assist the PLCOs in controlling MLIs.

Management Comments on the Finding and Audit Response

Management Comments. The Director, DLA, agreed that PLCOs may not have adequately monitored the disposal of some items that may have qualified as MLIs. However, the Director did not agree that PLCOs were not requiring contractors to furnish NSNs, even though they were available. The Director stated that contractors are only required to furnish NSNs for Government-furnished property. The Director also stated that the implementation of the Plant Clearance Automated Reutilization Screening System will improve the identification of MLIs assigned NSNs and that the demilitarization course has been improved. The Director expressed concern about the inaccuracy of assigned demilitarization codes because this condition prevents proper disposition of excess items. The Director nonconcurred with the management control weakness we identified in Appendix A related to the disposal of MLIs assigned NSNs.

Audit Response. We disagree with the Director, DLA's, comments. Only 88 of the 420 NSNs sampled were provided by Defense contractors. In addition, two of the 15 Defense contractors had provided the majority (63 of the 88) of the NSNs. The cognizant PLCOs never determined whether the remaining 332 items were assigned NSNs. Therefore, PLCOs were in no position to determine whether Defense contractors had complied with the requirements of FAR 45.606.

Our results show that PLCOs were not able to ensure Defense contractors provided available NSNs because they were not identifying whether or not excess items were assigned NSNs.

We agree with DLA's efforts to provide PLCOs with training modules on the use of the FLIS, and we agree with the improvements in the demilitarization training DLA has made or is planning. However, the Director, DLA, stated that the Plant Clearance Automated Reutilization Screening System will be implemented in May to June 1997 and will resolve these issues. We have requested that DLA notify us when the system has been fully implemented because development began in 1990, and implementation has been delayed several times since then.

We disagree with DLA on the materiality of the management control weakness. The weakness meets the materiality criteria of DoD Directive 5010.38, Management Control Program, August 26, 1996, because it impairs fulfillment

Finding B. Disposal of Munitions List Items With National Stock Numbers

of an operational objective, adequate control over property, and weakens safeguards against mismanagement of that property. The material weakness exists because the PLCOs were not identifying whether or not excess items were assigned NSNs. When this condition is resolved, further testing will be needed to determine whether the MLIs assigned NSNs are disposed of appropriately and the weakness has been remedied.

In the response to the final report, we request that the Director, DLA, reconsider his position on the existence of the material control weakness over the disposition of excess munitions list items.

Recommendations, Management Comments, and Audit Response

B.1. We recommend that the Director, Defense Contract Management Command:

a. Issue a memorandum to all DoD contractors that emphasizes the provisions of Federal Acquisition Regulation 45.605-5(d)(2), which requires Defense contractors to establish a procedure to furnish national stock numbers for all items on inventory schedules, when those numbers are available.

b. Issue a letter to plant clearance officers instructing them to query the Federal Logistics Information System to determine whether surplus items have been assigned national stock numbers that would assist in determining whether the items are munitions list items that require strict controls at disposal.

Management Comments. The Director partially concurred and stated that a memorandum addressing excess MLIs will be issued shortly to DCMC commanders, PLCOs, and contract administrators. The memorandum addresses the requirement for contractors to provide NSNs when reporting excess Government property and directs PLCOs to take full advantage of the information contained in the FLIS. It also reemphasizes demilitarization responsibilities. In conjunction with the memorandum, DLA stated that PLCOs will be provided computer-based training to assist them in identifying excess items assigned NSNs. DLA also stated that proposed revisions to the FAR and DFARS will largely remedy this problem since contractors will be required to provide NSNs and demilitarization codes on inventory schedules. In addition, the DLA stated that the implementation of Plant Clearance Automated Reutilization Screening System in May to June 1997 will also improve the process of properly identifying NSNs.

Audit Response. DLA and DCMC actions satisfy the intent of this recommendation. We believe the memorandum requiring contractors to provide NSNs when reporting excess Government property and directing PLCOs to take

Finding B. Disposal of Munitions List Items With National Stock Numbers

advantage of information in the FLIS will greatly assist in determining whether items are munitions list items. No further comments are required.

B.2. We recommend that the Director, Defense Logistics Agency, modify the existing demilitarization training program to provide clear instruction to plant clearance officers for the identification and control of munitions list items in the possession of Defense contractors.

Management Comments. The Director partially concurred and stated that training for DCMC personnel has improved considerably during the last 2 years. The Director stated that it has created an informal team consisting of DCMC property management personnel and the DoD Demilitarization course director to further enhance the course's relevance to the disposal of excess contractor inventory. The Director also stated that once proposed DFARS changes are approved, the course will include these changes to improve student's understanding of demilitarization requirements. In addition, the DLA stated that student comments about the course have been extremely favorable.

Audit Response. The DLA comments were responsive.

Part II - Additional Information

Appendix A. Audit Process

Audit Scope

The Defense Contract Management Command has oversight responsibility for Government-owned property at contractor facilities. Defense contractors must keep the official property records, establish property control systems, and identify surplus property. As of September 30, 1995, contractors held Government-owned property valued at about \$68 billion (acquisition value) on about 14,630 contracts. During FY 1994, Defense contractors disposed of about \$1.8 billion worth of surplus property.

Limitations of Audit Scope. The DCMC developed the Defense Automated Disposal System to track the length of time required to dispose of surplus Government property and to provide summary data about the dispositions. The Defense Automated Disposal System is not a property management system and does not track inventory on an item basis. In addition, due to system conversion problems, the DCMC was not able to compile any summary data pertaining to the dollar value of inventory disposed of by contractors during FY 1995. As a result, we were unable to determine how many items were disposed of by contractors during FY 1995, which contractors made the most disposals, how many items sold had or did not have national stock numbers, and how many items sold should have been categorized and controlled as MLIs.

Use of Computer-Processed Data. We did not use the DCMC Defense Automated Disposal System to complete the objective of the audit. The Defense Automated Disposal System does not track excess property on an item basis or track whether excess items are MLIs.

Audit Methodology

We selected 15 Defense contractors for review based on several factors, including the overall size of the Defense contractor, types of weapon systems being worked on, and discussions with DCMC property personnel about Defense contractors believed to have disposed of the most property. For small Defense contractors, we attempted to include some of the Defense contractors that worked on key components of weapon systems.

We took a judgmental sample of 1,820 items disposed of by 15 Defense contractor facilities. The number of items varied based on the availability of automated data at the contractor sites. Five Defense contractors had more sophisticated automated systems and were able to give us automated records on

surplus DoD property. For the other 10 Defense contractors, we reviewed available contractor and DCMC manual records.

Audit Period and Standards

This economy and efficiency audit was performed from May 1996 through November 1996. Audit results are based on controls in place for the disposal of surplus MLIs from 15 contractor facilities during FY 1995. The audit was made in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD. Accordingly, we included tests of management controls related to the identification of surplus MLIs and their disposal.

Organizations and Individuals Visited or Contacted

We visited or contacted individuals and organizations within the DoD and Action Manufacturing, Philadelphia, Pennsylvania; Allied Signal, Phoenix, Arizona; Hamilton Standard, Hartford, Connecticut; Kaman Aerospace, Hartford, Connecticut; Motorola, Scottsdale, Arizona. Further details are available on request.

Management Control Program

DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987,* requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of Review of Management Controls. We reviewed the adequacy of DCMC management controls over the identification and disposal of surplus MLIs. Specifically, we reviewed policies and procedures, management information systems, training programs, and the overall disposal process. We also reviewed proposed changes to existing policies.

Adequacy of Management Controls. We identified material management control weaknesses as defined by DoD Directive 5010.38. Management controls for identifying and controlling MLIs were not adequate.

*DoD Directive 5010.38 has been revised as "Management Control Program," August 26, 1996. The audit was performed under the April 1987 version of the directive.

Appendix A. Scope and Methodology

Recommendations A.1, A.2., and B.2., if implemented, will correct these weaknesses through contract reform and improved disposal requirements. A copy of the report will be provided to the senior official responsible for management controls in the Defense Logistics Agency.

Adequacy of Management's Self-Evaluation. The DCMC reviewed and identified the disposal of surplus contractor inventory as an assessable unit in FY 1995 and assigned the area a low level of risk. However, the DCMC did not identify munitions list items as a separate assessable unit. The DCMC did not report in its Annual Statement of Assurance any material weaknesses related to the disposal of surplus contractor inventory. Based on the weaknesses that we identified in the report and the risk of munitions list items being acquired by terrorists, we believe disposal of surplus contractor inventory should be rated as a high-risk area. We expect these adjustments will be made as the recommendations are implemented.

Appendix B. Prior Audits and Other Reviews

This is the third in a series of reports resulting from our audit of the controls over munitions list items. The audit was requested by the Director, Defense Logistics Agency. The first two reports are summarized below.

Inspector General, DoD, Report No. 96-143, "Transfer and Exchange of a Navy P-3A Aircraft," June 5, 1996. The objective of this portion of the audit was to determine whether the Navy effectively managed the transfer of reclaimable aircraft to museums.

The Navy planned to transfer a P-3A aircraft, with usable parts valued from \$1.7 million to \$4.1 million, to the Smithsonian's National Air and Space Museum. The museum, in turn, planned to exchange the P-3A for a historically significant business aircraft valued at \$245,000. As a result of our review, the Navy conducted further research and canceled the transfer. The Navy confirmed that it had current requirements for parts on the P-3A. In addition, the planned exchange was not in the best interest of the Government. Management actions resulted in monetary benefits of \$1.7 million to \$4.1 million. The report contains no findings or recommendations.

Inspector General, DoD, Report No. 96-229, "Disposition of Excess Army Helicopters and Flight-Safety-Critical Helicopter Parts," September 24, 1996. The objective of this portion of the audit was to determine whether the Army had effective controls over the redistribution and disposition of excess helicopters and helicopter parts.

The Aviation and Troop Command did not give the Defense Reutilization and Marketing Service correct instructions for disposing of flight-safety-critical parts that were released to the public without safety inspections. Consequently, \$37.5 million of flight-safety-critical parts were released to the public without safety inspections, and \$153.1 million of saleable parts were incorrectly coded for demilitarization. We recommended that the Commander, Aviation and Troop Command, modify the Component Tracking System to provide complete disposition instructions on flight-safety-critical parts by work-unit code. We also recommended that the Commander, Aviation and Troop Command, coordinate with the Defense Reutilization and Marketing Service and the Regional Logistics Support Offices to modify the Component Tracking System to provide complete disposition instructions on flight-safety-critical parts by work-unit code; provide retroactive instructions for disposing of previously reutilized, transferred, donated, or exchanged flight-safety-critical parts; and research the history of the flight-safety-critical parts already on hand at Defense Reutilization and Marketing Offices and national inventory control points before the parts are released.

The Aviation and Troop Command transferred 170 helicopters to the U.S. Army Center of Military History for exchange purposes, although the helicopters were not historic property. The Center of Military History incorrectly exchanged 86 of the helicopters for other historic property or contractor services. The helicopters that were exchanged were not properly

Appendix B. Prior Audits and Other Reviews

valued, and the exchanges were not reported to the Internal Revenue Service as required. The Center of Military History's actions did not comply with DoD policies on exchanges and valuation requirements of United States Code, title 10, section 2572 (10 U.S.C. 2572). The exchanges increased the risk that flight-safety-critical helicopter parts on the helicopters were released outside the DoD without the necessary safety inspections. We recommended that the Army Chief of Staff dispose of the 84 helicopters that were transferred to the Center of Military History in accordance with DoD and Army disposal policies; identify the 86 helicopters exchanged between the public and the Center of Military History to determine whether flight-safety-critical parts that were released should be recalled for inspection; and improve policies, procedures, and controls for implementing exchange provisions of DoD policies and 10 U.S.C. 2572.

The Defense Reutilization and Marketing Service did not reimburse the Aviation and Troop Command for the sale of excess helicopters and related parts. As a result, the Army's Defense Business Operations Fund will not receive about \$60 million from the sale of helicopters and \$10 million from the sale of helicopter engines. Redirecting those funds will give the Army the incentive to maximize proceeds on the sale of excess helicopters and related parts. We recommended that the Under Secretary of Defense (Comptroller) approve reimbursement to the Army of 80 percent of the proceeds from the sale of excess helicopters and related parts.

The Army agreed to publish policy requiring the inspection of helicopters prior to their exchange, destroy flight-safety-critical parts that are undocumented, crash damaged, or similarly compromised, inform recipients of helicopters and parts of the availability of historical data on flight-safety-critical parts, notify the end-users of the 86 helicopters of flight-safety-bulletins, revise Army Regulation 870-20, "Museums and Historic Artifacts," to include valuation procedures, abide by DoD policy on the reporting of exchanges to the IRS, and comply with the tenets of a legal opinion on the reimbursement for the sale of helicopters and related parts.

Appendix C. Demilitarization Codes

On February 14, 1995, DoD reduced the number of authorized demilitarization codes from 15 to 9. Those nine codes and their definitions are defined below.

- A** Non-MLI/nonstrategic list item. Demilitarization not required.
- B** MLI (nonsignificant military equipment). Demilitarization not required, trade security controls should be applied.
- C** MLI (significant military equipment). Remove and/or demilitarization installed key points.
- D** MLI (significant military equipment). Total destruction of items and components to prevent restoration or repair to a usable condition.
- E** MLI (nonsignificant military equipment). Additional critical items/materiel determined to require demilitarization, either key point or total destruction. Demilitarization instructions to be furnished by the DoD Demilitarization Program Office.
- F** MLI (significant military equipment). Demilitarization instructions to be furnished by the item/technical manager.
- G** MLI (significant military equipment). Demilitarization required--ammunition, explosives, and dangerous articles. Demilitarization and, if required, declassification will be accomplished prior to physical transfer to a Defense Reutilization and Marketing Office.
- P** MLI (significant military equipment). Security classified item. Declassification and any additional demilitarization and removal of sensitive markings will be accomplished prior to accountability or physical transfer to a Defense Reutilization and Marketing Office.
- Q** Strategic list item. Demilitarization not required.

Appendix D. United States Munitions List Items

1. Firearms
2. Artillery and projectors
3. Ammunition
4. Launch vehicles, guided missiles, ballistic missiles, rockets, torpedoes, bombs, and mines
5. Explosives, propellants, incendiary agents, and their constituents
6. Vessels of war and special naval equipment
7. Tanks and military vehicles
8. Aircraft, spacecraft, and associated equipment
9. Military training equipment
10. Protective personnel equipment
11. Military and space electronics
12. Fire control, range finder, optical and guidance and control equipment
13. Auxiliary military equipment
14. Toxicological agents and equipment and radiological equipment
15. Spacecraft systems and associated equipment
16. Nuclear weapons design and test equipment
17. Classified articles, technical data, and Defense services not otherwise enumerated
- 18 and 19. Reserved for future use
20. Submersible vessels, oceanographic and associated equipment
21. Miscellaneous articles

Appendix E. Proposed Modification to Defense Federal Acquisition Regulation Supplement

The Defense Acquisition Regulations Council has proposed placing additional requirements on Defense contractors in identifying MLIs. If those requirements are implemented, Defense contractors would have to provide demilitarization codes for the MLIs reported as excess property on inventory schedules. The demilitarization codes would be assigned at the time of excess. We agree that contractors should be required to assist DoD in identifying and controlling MLIs; however, we disagree with the proposed point in time that MLIs would be identified. Specifically, contractors should not delay classifying items as MLIs until the items are ready for disposal.

The change proposed below to the DFARS section 252.245-7XXX clause, in conjunction with our recommended changes to DoD 4160.21-M-1, "Defense Demilitarization Manual," will provide the most effective means of identifying and controlling MLIs in the possession of Defense contractors. The suggested text for the clause (shown below) would include all MLIs required on Defense contracts in the possession of Defense contractors regardless of ownership:

For property required in the performance of Government contracts, regardless of ownership and to prevent misuse by unauthorized individuals, the contractor shall coordinate with the appropriate DoD officials (DoD Demilitarization Program Office) to assist in identifying munitions list items at the earliest identifiable point in time and the appropriate level of control during production and disposal.

Appendix F. Sample Munitions List Items With Assigned National Stock Numbers

Of the 1,820 surplus sample items sold from 15 Defense contractors, 420 were assigned national stock numbers. Of the 420 items assigned a national stock number, 155 were munitions list items. The 155 munitions list items are shown in tables F-1 and F-2 below, along with their DoD weapon system or military application.

Table F-1. 111 Munitions List Items Requiring Trade Security Controls

<u>NSN</u>	<u>Description</u>	<u>Weapon System or Application</u>
1560-00-001-7957	C-5 Bracket Assembly	C-5 Aircraft
1620-00-147-9301	Guide, Switch C-5	C-5 Aircraft
1560-00-260-0169	End Rib	C-5 Aircraft
1560-01-205-1183	Feed Line Assembly	F-16 Aircraft
1560-00-438-0009	Screen Sensor Housing	F-16 Aircraft
2840-01-308-7636	Lubricant Tank	F14/15 Engine
2915-01-305-4970	Fuel Control	F14/15 Engine
2915-01-310-2892	Fuel Control	F14/15 Engine
2995-01-313-0343	Valve Assembly	F14/15 Engine
2805-00-003-0747	Ring, Piston	F5E Engine
2840-00-152-6703	Blade, Compressor Rotor	F5E Engine
2840-00-317-3693	Insulation Blanket	F5E Engine
2840-01-038-3317	Blade, Compressor, Aircraft	F5E Engine
2840-01-041-9522	Nut Half, Blade Lock	S3A/A10 Engine
2840-01-041-9523	Nut Half	S3A/A10 Engine
2840-01-041-9552	Blade, Compressor Rotor	S3A/A10 Engine
2840-01-041-9553	Blade, Compressor Rotor	S3A/A10 Engine
2840-00-595-7303	Nozzle Assembly, Turbine	S3A/A10 Engine
2840-01-124-4055	Segment Assembly	F-18 Engine
2840-01-124-7830	Clamp Half, Tube	F-18 Engine
2840-01-130-2761	Shaft, Rear, Fan Rotor	F-18 Engine
2840-01-130-2762	Retainer, Shroud-Turbine	F-18 Engine
2840-01-130-2766	Retainer, Shroud-Turbine	F-18 Engine
2840-01-130-2776	Linkage, Centering	F-18 Engine
2840-01-131-0445	Vane Segment	F-18 Engine
2840-01-131-4756	Seal Ring, Bearing	F-18 Engine
2840-01-131-8636	Baffle, Rotor Blade	F-18 Engine
2840-01-135-1481	Support, Shroud-High	F-18 Engine
2840-01-136-4313	Segment and Seal	F-18 Engine
2840-01-139-7171	Shroud, Support	F-18 Engine

Appendix F. Sample Munitions List Items With Assigned National Stock Numbers

Table F-1. 111 Munitions List Items Requiring Trade Security Controls (cont'd)

<u>NSN</u>	<u>Description</u>	<u>Weapon System or Application</u>
2840-01-139-7333	Vane, Compressor Stator	F-18 Engine
2840-01-140-3402	Bearing Housing	F-18 Engine
2840-01-144-4111	Support, Shroud	F-18 Engine
2840-01-139-7211	Tie-Rod, Transmitter	F-18 Engine
2840-01-216-7996	Shroud, Stator	F-18 Engine
2840-01-216-7997	Shroud, Stator	F-18 Engine
2840-01-150-6659	Seal Ring, Bearing	F-18 Engine
2840-01-320-4326	Blade, Turbine Engine	F-18 Engine
2840-01-389-2504	Blade, Fan, Aircraft Gas	F-18 Engine
2915-01-215-5658	Transmitter, Compressor	F-18 Engine
2915-01-396-9574	Spray Tip, Nozzle, Fuel	F-18 Engine
3130-01-184-9673	Support, Bearing	F-18 Engine
5330-01-123-2239	Seal, E-Type	F-18 Engine
5330-01-135-8780	Seal, Main Spraybar	F-18 Engine
5340-01-123-2254	Bracket, Tube Support	F-18 Engine
5340-01-130-2772	Clevis, Tie Rod	F-18 Engine
2840-01-291-3021	Blade, Compressor Rotor	F-18 Aircraft
2840-01-291-9504	Blade, Compressor Rotor	F-18 Aircraft
5995-01-154-2855	Cable Assembly, Power	F-18 Aircraft
2840-01-318-1209	Blade, Turbine Engine	F-18 Aircraft
2840-01-129-3780	Blade, Compressor Rotor	F104 Engine
2840-01-129-3778	Blade, Compressor Rotor	F104 Engine
2840-01-130-2939	Blade, Compressor Rotor	F104 Engine
2840-01-129-3804	Shaft, Turbine	F104 Engine
2840-01-131-0569	Vane, Compressor Stator	F104 Engine
2840-01-134-5331	Disk, Axial Compressor	F104 Engine
2840-01-139-7330	Vane, Compressor Stator	F104 Engine
2840-01-144-4283	Vane, Compressor Stator	F104 Engine
2840-01-157-8736	Disk, Turbine	F104 Engine
2915-01-138-8052	Spraybar, Main	F104 Engine
6150-01-166-3274	Cable Assembly, Power	F104 Engine
4730-01-169-1734	Plug, Igniter	F402 (X29) Engine
6625-01-037-0421	X-Y Recorder	E-4B Aircraft
2840-00-966-8058	Nozzle Assembly, Aircraft	TF-33 Engine
2840-01-280-9858	Retainer, Shroud	Apache/Blackhawk Engine
2840-01-299-1528	Nozzle, Turbine	Apache/Blackhawk Engine
2840-01-362-4937	Shaft, Turbine	Apache/Blackhawk Engine
2840-01-362-4937	Shaft, Turbine	Apache/Blackhawk Engine
2945-01-115-3562	Screen Assembly	CH-47 Helicopter
1730-00-878-0352	Protective Equipment	CH-47 Helicopter

Appendix F. Sample Munitions List Items With Assigned National Stock Numbers

Table F-1. 111 Munitions List Items Requiring Trade Security Controls (cont'd)

<u>NSN</u>	<u>Description</u>	<u>Weapon System or Application</u>
2945-01-116-4224	Screen Assembly	CH-47 Helicopter
1560-01-117-1081	Panel Assembly	CH-47 Helicopter
1615-00-181-4127	Retainer	CH-47 Helicopter
2840-01-122-6555	Tail Cone, Engine	CH-47 Helicopter
1560-01-142-8787	Carrier	CH-46 Helicopter
2840-01-087-1845	Blade, Turbine Engine	UH-60 Engine
5340-01-139-7414	Clip, Spring Tension	Aircraft Engine
6620-01-124-0947	Transmitter, Pressure	Aircraft Engine
2915-00-078-2310	Nozzle, Fuel Injection	Aircraft Engine
6620-01-151-0620	Transmitter, Pressure	Aircraft Engine
2925-01-121-0761	Igniter Engine	Aircraft Engine
2520-01-159-4482	Heat Exchanger	Aircraft Engine
2840-00-009-7608	Vane, Compressor Stator	Aircraft Engine
2840-00-033-7247	Blade, Turbine, Rotor	Aircraft Engine
2840-00-033-7254	Blade, Compressor Rotor	Aircraft Engine
2840-00-059-6406	Blade, Turbine, Rotor	Aircraft Engine
2840-00-143-4350	Shroud Sector, Turbine	Aircraft Engine
2840-00-169-7467	Blade, Compressor Rotor	Aircraft Engine
2840-00-169-7472	Blade, Compressor Rotor	Aircraft Engine
2840-00-887-1561	Shaft, Turbine	Aircraft Engine
2995-00-134-4682	Starter	Aircraft Engine
2995-01-162-6969	Valve Assembly	Aircraft Engine
1615-01-112-5890	Lubricator	Aircraft Engine
2840-01-099-2363	Support Shroud, Turbine	Aircraft Engine
3040-01-115-3621	Housing	Aircraft Engine
1560-01-203-7967	Support	Aircraft Parts
1560-01-220-3014	Fairing	Aircraft Parts
1560-01-243-4218	Fairing, Nose Gear Box	Aircraft Parts
1560-01-244-6336	Fairing, Nose Gear Box	Aircraft Parts
1615-01-179-0777	Actuator, Support	Aircraft Parts
1560-01-161-1187	Armor	Aircraft Parts
2915-01-028-8286	Fuel Control, Main Turbine	Aircraft Parts
1560-00-073-1073	Fitting Assembly	Aircraft Parts
1680-00-140-1818	Retainer, Ball, Front	Aircraft Parts
1560-01-115-3669	Nose Fairing	Aircraft Parts
2840-01-166-4886	Nozzle, Segment Turbine	Aircraft Combustion Module
5895-00-089-4403	Control Transponder	Aircraft Test Equipment
6625-00-478-1411	Counter, Frequency	Aircraft Test Equipment
5365-01-167-1504	Shim, Aluminum	Aircraft Test Equipment
6625-00-601-0486	Transducer, Motional Pick-up	Aircraft Test Stand
1430-00-009-6032	Heads (Peacekeeper)	Missile

Appendix F. Sample Munitions List Items With Assigned National Stock Numbers

Table F-2. 44 Munitions List Items Requiring Demilitarization Controls

<u>NSN</u>	<u>Description</u>	<u>Weapon System or Application</u>
5999-01-117-8598	Card Assembly	F-16 Aircraft
5999-01-146-1533	Circuit Card Assembly	F-16 Aircraft
2840-00-605-3212	Liner, Transition	S3A/A10 Engine
2840-01-089-4137	Shaft, Compressor	S3A/A10 Engine
2840-01-124-0903	Actuator Assembly	F104 Engine
2840-01-131-4730	Bearing Support	F-18 Engine
2840-01-131-4745	Seal Assembly, Engine	F-18 Engine
2840-01-150-6660	Seal Assembly, Engine	F-18 Engine
5340-01-365-5463	Bracket, Mounting	F-18 Engine
3110-01-343-3763	Bearing, Roller, Cylinder	F-18 Engine
3110-01-359-7286	Bearing, Roller, Cylinder	F-18 Engine
2840-01-227-0377	Rotor, Turbine, Aircraft	F5E Engine
1615-01-097-5071	Aircraft Components	H-2 Aircraft
2840-00-802-5679	Disk Compressor, Turbine	TF-33 Engine
2840-01-227-0377	Rotor, Turbine, Aircraft	F5E Engine
3130-01-327-3606	Bearing, Unit, Ball	J-52 Type Engine
1615-01-154-7078	Shaft Input	Apache Helicopter
1615-01-188-4530	Coupling Assembly	Apache Helicopter
1615-01-172-4974	Strap Assembly	Apache Helicopter
5826-01-183-5499	Radio Magnetic	Apache Helicopter
1270-01-186-8956	Panel Unit	Apache Helicopter
1650-01-183-9529	Motor, Hydraulic	Apache Helicopter
1005-01-211-4165	Gun Control Box	Apache Helicopter
1615-01-166-1963	Master Assembly	Apache Helicopter
1615-01-165-1028	Strut	Apache Helicopter
1615-01-154-7076	Strap Assembly	Apache Helicopter
1560-01-242-1495	Bellcrank Assembly	Apache Helicopter
5998-01-192-2189	Circuit Card Assembly	Apache Helicopter
1095-01-057-4592	Control Box Dispenser	M130 General Dispenser (Apache)
1095-01-057-0027	Module, Flare	M130 General Dispenser (Apache)
1615-01-088-4684	Retainer Assembly	CH46/7 Helicopter
5895-01-011-9846	Recorder, Tape, Airborne	CH46/7 Helicopter
6620-00-612-7743	Torque Indicator	Aircraft Parts
2840-00-033-7236	Panel, Fan	Aircraft Parts
2840-00-042-1326	Panel, Fan Pylon	Aircraft Parts
2840-00-146-5495	Liner, Combustion	Aircraft Parts
2840-00-146-5529	Vane Sector, Compressor	Aircraft Parts
2995-00-100-5033	Cylinder Assembly	Aircraft Engine
2995-00-276-4994	Valve, Anti-Icing	Aircraft Parts
1095-01-036-6886	Dispenser	Aircraft Parts
2840-01-169-1798	Chamber, Comb, Turbine	Aircraft Engine
5841-01-024-7739	Comparator	Electronic Equipment
5820-00-870-4075	Control, Amplifier	Radio Set
5985-01-067-8610	Spiral Antenna	Electronic Countermeasures

Appendix G. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition and Technology
Deputy Under Secretary of Defense (Industrial Affairs and Installations)
Deputy Under Secretary of Defense (Logistics)
Director, Defense Acquisition Regulations Council
Director, Defense Logistics Studies Information Exchange
Director, Defense Procurement
Under Secretary of Defense (Comptroller)
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)
Under Secretary of Defense for Policy
Assistant to the Secretary of Defense (Public Affairs)

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Assistant Secretary of Navy (Financial Management and Comptroller)
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Logistics Agency
Commander, Defense Contract Management Command
Director, Defense Investigative Service
Director, National Security Agency
Inspector General, National Security Agency
Inspector General, Defense Intelligence Agency
Inspector General, National Imagery and Mapping Agency

Non-Defense Federal Organizations

Office of Management and Budget
Technical Information Center, National Security and International Affairs Division,
General Accounting Office

Chairman and ranking minority member of each of the following congressional committees and subcommittees:

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on National Security, Committee on Appropriations
House Committee on Government Reform and Oversight
House Subcommittee on Government Management, Information and Technology,
Committee on Government Reform and Oversight
House Subcommittee on National Security, International Affairs, and Criminal
Justice, Committee on Government Reform and Oversight
House Committee on National Security

Part III - Management Comments

Director, Defense Procurement, Comments



ACQUISITION AND
TECHNOLOGY

OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON, DC 20301-3000



Feb 06, 1997

DP (DAR)

MEMORANDUM FOR ACTING DIRECTOR, FINANCIAL AND ACCOUNTING
DIRECTORATE, INSPECTOR GENERAL, DEPARTMENT OF
DEFENSE

SUBJECT: Audit Report on Disposal of Munitions List Items in
Possession of Defense Contractors (Project 5FJ-5024.02)

This is in response to your request for comments on the
subject report. We are attaching for your consideration our
response to the specific recommendation that is directed to the
Director of Defense Procurement. Thank you for the opportunity
to comment on the report.

Eleanor R. Spector
Director, Defense Procurement

Attachment



Response to Draft DoDIG Report No. 5FJ-5024.02

DoDIG Recommendation A.2: We recommend that the Director, Defense Procurement, implement a change to the proposed Defense Federal Acquisition Regulation Supplement section 252.245-7XXX clause for future DoD contracts. See Appendix E for suggested wording.

- The clause should require that when Government property is required to perform a contract, the contractor shall coordinate with the appropriate DoD officials in the DoD Demilitarization Program Office to assist in identifying munitions list items at the earliest point in time and to identify the appropriate level of control required during the production and disposal of each item.
- The clause should also discuss contractor-owned and lost property that meets the definition of munitions list items that require special handling instructions at disposal.

DDP Response: Do not concur. We do not agree that contractors should be required to coordinate with the DoD Demilitarization Program Office. The contractors' point of contact should be their local Government contract administration offices. If necessary, the Government plant clearance officer can request assistance from the military department inventory control point for a particular item. There is no DoD Demilitarization Program Office with the capability of providing this kind of contractor interface.

We do not agree that munitions list items need to be identified at the earliest point in time. The applicable Government property clauses (Federal Acquisition Regulation (FAR) 52.245-2 or 52.245-5) require contractors to establish and maintain programs for the protection of Government property. This requirement has been successful in protecting Government property from being used for other than performance of Government contracts. We are not aware of, nor does the audit report identify, any extensive unauthorized use of Government property, and in particular munitions list items, by domestic or foreign entities during contract performance. The identification of the earliest point in time during production that each item of Government property may become subject to munitions list requirements at disposal would involve extensive engineering evaluation of a huge number of continuously changing production items. Under Government contracts, the demilitarization and trade security controls requirements only apply to disposal of Government property. Not all of the Government property accountable under a contract normally requires disposal at the end of contract performance. Requiring contractors to evaluate

each item manufactured or acquired under every Government contract at the earliest point in time is neither practical nor cost effective. A new draft of the Demilitarization and Trade Security Controls clause that will be published as a proposed rule requires contractors to assign demilitarization codes prior to disposal of Government property.

We do not agree that the clause should discuss contractor-owned property. Requirements for the control and disposition of contractor-owned property are outside the scope of Government contract requirements and should not be included in a DFARS clause. The requirement for contractors to control and report loss of all Government property is contained in the applicable Government property clauses (FAR 52.245-2 or 52.245-5).

The draft Defense Federal Acquisition Regulation Supplement (DFARS) rule under DFARS Case 92-D024 requires contractors to provide demilitarization codes on inventory schedules generated to report excess Government property for all items requiring demilitarization and/or trade security controls, and requires plant clearance officers to ensure contractors include appropriate demilitarization codes.

Draft DFARS 252.245-7XXX, paragraph (b) reads as follows:

(b) *Inventory schedules.*

The Contractor shall ensure that demilitarization codes (see DoD 4160.21-M-1, Defense Demilitarization Manual, Appendix 3) are included on inventory schedules generated to report excess Government property for all items requiring demilitarization and/or trade security controls.

Draft DFARS 245.604-70(c)(1) reads as follows:

(c) *Procedures.*

- (1) The Government is responsible for assigning and providing a demilitarization code, in accordance with DoD 4160.21-M-1, for each item of Government property when it is furnished to a contractor. The plant clearance officer shall ensure the contractor includes an appropriate demilitarization code for all items requiring demilitarization and/or trade security controls on inventory schedules generated to report excess Government property.

Defense Logistics Agency Comments



DEFENSE LOGISTICS AGENCY
HEADQUARTERS
8725 JOHN J. KINGMAN ROAD, SUITE 2533
FT. BELVOIR, VIRGINIA 22060-6221

IN REPLY
REFER TO

DDAI

21 FEB 1997

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING,
DEPARTMENT OF DEFENSE

SUBJECT: Draft Report on Disposal of Munitions Items in Possession of Defense
Contractors, 5FJ-5024.02

Enclosed is our response to the findings on the subject report. Our comments to the
recommendations were sent on 13 February 1997.

Encl

Oliver Coleman
Oliver Coleman
Acting Chief, Internal Review Office

cc:
AQCBE
AQOE
FOE

SUBJECT: Disposal of Munitions List Items in Possession of Defense Contractors,
SFJ-5024.02

FINDING A: Identification and Controls Over Surplus Munitions List Items Not Assigned National Stock Numbers. At the 15 contractor locations we visited, DoD and Defense contractor personnel generally did not identify whether items used by contractors to develop and field weapon systems were MLIs. Of the 1,820 items we sampled, 1,400 had not been reviewed or categorized as an MLI or non-MLI. The sample items included components, test equipment, and special tooling for weapon systems. DoD and contractor personnel did not consider whether the items were MLIs because:

- policies and procedures were not in place to assist DoD and contractor personnel in identifying MLIs when they had no NSNs, and
- contracts did not require Defense contractors to assist DoD personnel in identifying MLIs not assigned NSNs.

Additionally, the DCMC proposal to modify the Defense Federal Acquisition Regulation Supplement (DFARS) needed supplementation to assign responsibility for identifying MLIs during the acquisition cycle, and to address contractor-owned and lost property.

As a result, when items were no longer needed, the DCMC directed Defense contractors to sell them, without knowing whether the items required demilitarization or trade security controls. Improved controls are needed as an anti-terrorism prevention measure.

DLA COMMENTS: Partially concur. We don't disagree that in some cases DCMC Plant Clearance Officers (PLCOs) may not have been adequately reviewing excess items of Government property to determine whether they qualified as MLI. However, we do not agree with the reasons for this problem that are stated in the draft audit report. The draft report states that policies and procedures were not in place to assist DoD personnel in identifying MLI when the items had no NSNs. PLCO responsibilities regarding demilitarization, including identification of demilitarization requirements for both NSN and non-NSN items, are set forth in Appendix L to Chapter 5, Part 8 of the DLAD 5000.4. For items without NSNs, PLCOs are required to consult with government or contractor technical personnel, inventory managers, or the Defense Reutilization and Marketing Service in order to determine proper demilitarization requirements. Limited additional policies are contained in DFARS Part 245.

The draft report also states that contracts did not require defense contractors to assist DoD personnel in identifying MLI that did not have NSNs assigned. While DCMC PLCOs are unable to do anything about this problem (since they can only administer the existing terms of assigned contracts), DCMC Headquarters has sponsored a DFARS change that would clearly require contractors to identify demilitarization requirements for non-NSN items. When implemented, this policy revision will remedy the problem identified by the draft report.

The draft report also states that the DCMC proposal to modify the DFARS needed

supplementation to assign responsibility for identifying MLI during the acquisition cycle, and to address contractor-owned and lost property. This proposed change to the DFARS was approved by the Defense Acquisition Regulatory Council and published as a proposed rule in the Federal Register. After minor revisions based on public comments, it will again be issued as a proposed rule. The policies proposed by the DFARS case are now DoD proposed policies. Therefore the draft report's recommendation (Recommendation A.2.) correctly was directed at the Office of the Director, Defense Procurement and not DCMC. However, we agree with the position of the Director, Defense Procurement, in nonconcurring with that recommendation.

We do agree that improved controls are needed in the area of demilitarization. In addition to introducing and sponsoring improved coverage for the DFARS, we are ensuring all PLCOs have access to and understand how to use FEDLOG in order to identify NSNs. We are also providing them with several computer-based training modules that address demilitarization and which should facilitate proper disposition. We are also working with the Army Logistics Management Center to revise the DoD Demilitarization Course and make it more relevant to disposal of property from contractors' plants. Finally, we have issued a memorandum (DCMC memorandum 97-22, Demilitarization of Contractor Inventory, dated February 11, 1997) (See attachment) to all DCMC field officers to remind them of their responsibilities in this critical area. We believe that our actions in addressing the demilitarization issue on several fronts will result in improved disposition of MLI and SLI.

INTERNAL MANAGEMENT CONTROL WEAKNESS: *Nonconcur.*

ACTION OFFICER: Paul Farley, AQOE, 767-2443

APPROVAL: Gary S. Thurber, Associate Director, Acquisition

COORDINATION: D. Stumpf, DDAI

DLA APPROVAL: *Oliver Culman*

Attachment

AUDIT TITLE: Disposal of Munitions List Items in Possession of Defense Contractors, SFJ-5024.02

FINDING B: Disposal of Munitions List Items with National Stock Numbers. The DCMC did not adequately monitor the disposal of 155 items that were identified as MLIs at the 15 contractor locations we visited. The MLIs were not adequately monitored because:

- Defense contractors were not required to furnish NSNs, even though they were available;
- the DCMC did not use available automated data bases to retrieve demilitarization codes, and
- DoD demilitarization training was ineffective.

As a result, the 155 items were sold without application of the required trade security or demilitarization controls.

DLA COMMENTS: Partially concur. In some cases DCMC PLCOs may not have adequately monitored the disposal of some items that may have qualified as MLI. However, we do not agree with the reasons cited by the draft audit report for this problem.

The draft audit report states that one reason for this problem was that defense contractors were not required to furnish NSNs, even if they were available. The issue of when contractors must provide NSNs is discussed in detail in our response to Recommendation B.1. Given the current FAR policies, contractors are not required to provide NSNs unless the Government has in fact provided the NSN to them with the property that was furnished. In such cases PLCOs are clearly required to ensure that the NSN is reported when the item is reported excess. Contractors are not currently required to report NSNs for property which they acquire or fabricate and to which the Government has title. Proposed changes to the FAR and DFARS will remedy that problem. However, until such changes are implemented, DCMC PLCOs can only encourage contractors to submit NSNs for other than items where NSNs were provided with the property. DCMC Memorandum No. 97-22 directed PLCOs to encourage contractors to submit NSNs for contractor acquired or fabricated property.

The report also stated that MLI were inadequately monitored because DCMC did not use available automated data bases to retrieve demilitarization codes, and because DoD demilitarization training was ineffective. Detailed responses to statements are contained in our answers to Recommendations B.1. and B.2.

DCMC fully appreciates the importance of ensuring proper disposition for MLI and SLI, and we are pursuing improvements in a number of areas. A major issue which cannot be remedied by DCMC, however, is the widely acknowledged inaccuracy of the demilitarization codes themselves. Estimates of inaccuracy of the demilitarization codes run as high as fifty percent. Therefore, we cannot really agree or disagree with the draft report's statement that 155 items were sold without application of the required trade security or demilitarization controls. Even if our PLCOs identify the "official" demilitarization code to every item and ensured disposition

was consistent with the requirements identified by the code, the inaccuracy of the codes themselves in many cases precludes proper disposition. We have brought this matter to the attention of the DoD Demilitarization Program Manager as a major issue that must be resolved if we are to achieve our common objective of proper disposition of all MLI and SLI.

INTERNAL MANAGEMENT CONTROL WEAKNESS: Nonconcur.

ACTION OFFICER: Paul Farley, AQOE

PSE APPROVAL: Gary S. Thurber, Associate Director, Acquisition

COORDINATION: D. Stumpf, DDAI, 767-6266

DLA APPROVAL: *Oliver E. Culver*

Defense Logistics Agency Comments

Final Report
Reference



IN REPLY
REFER TO

AQOE

DEFENSE LOGISTICS AGENCY
THE DEFENSE CONTRACT MANAGEMENT COMMAND
5725 JOHN J. KINGMAN ROAD, SUITE 2533
FT. BELVOIR, VIRGINIA 22060-6221

February 11, 1997

MEMORANDUM FOR COMMANDERS, DEFENSE CONTRACT MANAGEMENT
DISTRICTS

SUBJECT: DCMC Memorandum No. 97-22, Demilitarization of Contractor Inventory
(INFORMATION)

This is a POLICY memorandum effective immediately and ending September 30, 1997.
Target audience: Contract Administration Office Commanders, Plant Clearance Officers,
Property Administrators, and Administrative Contracting Officers.

A recent draft DoD Inspector General report stated that DCMC Plant Clearance Officers (PLCOs) were not making inquiries into the Federal Logistics Information System (FEDLOG) to determine whether excess Government property had been assigned national stock numbers (NSNs) that would identify them as munitions list items (MLI). Districts must ensure that PLCOs have access to FEDLOG, are fully familiar with its use, and are employing it to identify NSNs. We will shortly be furnishing PLCOs with several computer-based training modules that address the area of demilitarization in order to facilitate the identification of NSNs for MLI.

The DoD Inspector General report also stated that PLCOs were not requiring contractors to provide available NSNs when reporting excess Government property. The current policy contained in the Federal Acquisition Regulation (FAR) at subparagraph 45.505-1(a) states that NSNs, if furnished by the Government or available in the contractor's property control system, shall be provided as basic information for items of Government property. FAR 45.606-5(d)(2) requires these NSNs to be reported on inventory schedules. Therefore, if contractors were provided NSNs with the property that was furnished to them, the NSN should be available and is required to be reported on inventory schedules.

New policy in this area that has been proposed for inclusion in the FAR will clearly require contractors to maintain NSNs as part of standard property records information and to report the NSNs and the demilitarization codes when declaring either Government-furnished or contractor-acquired or fabricated property excess. Until this policy is implemented, PLCOs should strongly encourage contractors to provide NSNs for contractor-acquired or contractor-fabricated property to which the Government has title on future submissions of inventory schedules.


The DoD Inspector General also recommended that existing demilitarization training needed to be improved in order to provide clear instructions to PLCOs for the identification

Response to
Recommendation B.1.a.
and 1.b.

2

and control of MLI in the possession of defense contractors. We have reviewed student course critiques from DCMC students who have attended the DoD Demilitarization course during the last 2 years and found that they generally rated the course as excellent. Nonetheless, we will be working with the U.S. Army Logistics Management Center to enhance the course and improve its relevance to plant clearance. Districts are reminded that attendance at this course is mandatory for all DCMC property management personnel.

PLCOs should follow the guidance contained in Appendix L of Chapter 5, Part VIII of DLAD 5000.4 regarding demilitarization. The Defense Reutilization and Marketing Service (DRMS) is also available to answer questions regarding demilitarization. Questions may be forwarded to DRMS, ATTN: DRMS-SOM, 74 N Washington Avenue, Battle Creek, MI 49017-3092. DRMS has also established a demilitarization help line to answer questions, which may be reached at 1-800-219-8168. We hope to have both the expanded DoD FAR Supplement and FAR policies on demilitarization and the revised DoD Demilitarization Manual published in the next few months. We are also working with the DoD Demilitarization Program Manager to better define demilitarization requirements for special tooling. This additional guidance, together with improved training, should significantly improve our ability to ensure proper disposal of both MLI and strategic list items.


JILL E. PETTIBONE
Executive Director
Contract Management Policy

Defense Logistics Agency Comments



DEFENSE LOGISTICS AGENCY
HEADQUARTERS
8725 JOHN J. KINGMAN ROAD, SUITE 2533
FT. BELVOIR, VIRGINIA 22060-6221

IN REPLY
REFER TO

DDAI

13 FEB 1997

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING
DEPARTMENT OF DEFENSE

SUBJECT: Draft Report on Disposal of Munitions Items in Possession of Defense
Contractors, 5FJ-5024.02

Enclosed is our response to your December 9, 1996. Comments to the Findings are incomplete
and will be forwarded to you when they are completed.

Encl


Oliver Coleman
Acting Chief, Internal Review Office
Internal Review Office

cc:
AQCBE
AQOE

Federal Recycling Program  Printed on Recycled Paper

FEB 13 1997

SUBJECT: Disposal of Munitions List Items in Possession of Defense Contractors, 5FJ-5024.02

RECOMMENDATION A.1: Recommend that the Director, Defense Logistics Agency, establish a working group with members from the offices of the Component Acquisition Executives to establish policies in DoD 4160.21-M-1, "Defense Demilitarization Manual," October 1991, that assist DoD and Defense contractors in identifying and controlling munitions list items that are acquired by Defense contractors, but are not assigned national stock numbers.

DLA COMMENTS: Partially concur. Changes necessary to the DoD Demilitarization Manual, DoD 4160.21-M-1, which will assist contractors in controlling MLI/SLI have already been drafted and will be incorporated in the 1997 rewrite. This new language was formulated by the DoD Demilitarization Program Manager and the DLA Materiel Management Disposal Programs Team, in conjunction with the Defense Contract Management Command (DCMC) Headquarters, and was coordinated with the DoD Demilitarization Policy Working Group (DDPWG). It is the responsibility of the DDPWG to coordinate any changes to DoD demilitarization policy with the appropriate offices of primary interest within their Military Departments. Therefore, policies for the identification of MLI/SLI, including those that do not contain national stock numbers (NSNs), have already been developed and fully coordinated.

With regard to MLI/SLI in the possession of contractors, the DoD 4160.21-M-1 provides direction primarily for Government property that has been furnished to contractors. For property that is acquired by contractors as a direct charge to a Government contract (and therefore meets the FAR definition of Government property), policy that has been proposed for inclusion in the DoD FAR Supplement assigns responsibility for identification and control to the contractor. We believe that the contractor is in the best position to exercise these responsibilities for property that he purchases, charges to Government contracts, and controls as part of his property control system. Additional policies that have been proposed for the FAR require contractors to maintain NSNs for all items of Government property in their possession, and also require contractors to report demilitarization codes when the property is reported excess. These policy revisions should improve the control and identification of MLI and SLI.

DISPOSITION: Action is Considered Complete

ACTION OFFICER: Paul Farley, AQOE, 767-2443

APPROVAL: Gary S. Thurber, Associate Director, Acquisition

COORDINATION: Dave Stumpf, DDAI, 767-6266

DLA APPROVAL: *Robert E. Calhoun*

FEB 13 1997

SUBJECT: Disposal of Munitions List Items in Possession of Defense Contractors, 5FJ-5024.02

RECOMMENDATION B.1: Recommend that the Commander, Defense Contract Management Command: Issue a memorandum to all DoD contractors that emphasizes the provisions of Federal Acquisition Regulation 45.605-5(d)(2), which requires Defense contractors to establish a procedure to furnish national stock numbers for all items on inventory schedules, when those numbers are available.

Issue a letter to plant clearance officers instructing them to query the Federal Logistics Information System to determine whether surplus items have been assigned national stock numbers that would assist in determining whether the items are munitions list items that require strict controls at disposal.

DLA COMMENTS: Partially concur. The Commander of DCMC cannot issue a memorandum to all DoD contractors, since many DoD contractors are not assigned to DCMC for contract administration. In addition, since DCMC's relationship with contractors is contractual, any direction to contractors is best provided by appointed representatives of the procuring contracting officers, such as Plant Clearance Officers (PLCOs).

However, we have prepared a memorandum to DCMC Commanders, PLCOs, and property administrators that will be issued shortly that addresses the requirements for contractors to provide NSNs when reporting excess Government property, directs PLCOs to take full advantage of the information contained in FEDLOG relative to identification of NSNs, and reemphasizes their responsibilities in the area of demilitarization. In addition, we will be providing them with computer-based training modules designed by the Defense Logistics Service Center that will assist PLCOs in improving the identification of NSNs.

Subparagraph 45.606-5(d)(2) of the FAR states that contractors shall report NSNs for excess items when submitting inventory schedules. However, FAR 45.505-1(a) requires contractors to provide NSNs as basic information for items of Government property only if the NSN was furnished by the Government or is available in the contractor's property control system. The provisions of FAR Subpart 45.5 are clearly incorporated as contractual requirements through the applicable property clause; however, the provisions of FAR Subpart 45.6 are not contractual. Therefore, if NSNs were provided to the contractor with the property that was furnished (normally identified on the shipping document, such as DD Form 1348-1), then that information should be part of the contractors' property control system and should be reported on inventory schedules. However, if no NSN was provided to the contractor, or in the case of contractor-acquired or contractor-fabricated property to which the Government has title, we can at this time only encourage contractors to provide the NSNs. New policy that is proposed for inclusion in the FAR and DoD FAR Supplement will largely remedy this problem by clearly requiring both NSNs and demilitarization codes be included in property control system and reported on inventory schedules. Until issuance of this revised policy, however, PLCOs cannot direct contractors to submit NSNs for other than items where the NSNs were provided with the property. However, since many contractors are cooperative in trying to provide NSNs for all applicable items, we will advise our PLCOs to strongly encourage assigned contractors to submit

FEB 13 1997

NSNs for all excess property.

Improving NSN identification will also be facilitated by the implementation of the DCMC Plant Clearance Automated Reutilization Screening System (PCARSS), which is scheduled for deployment in May-June 1997. PCARSS will automatically validate NSNs or match part numbers with NSNs through electronic interface with the Defense Logistics Services Center.

DISPOSITION: Action is Ongoing. **ECD:** March 1, 1997

ACTION OFFICER: Paul Farley, AQOE

APPROVAL: Gary S. Thurber, Associate Director, Acquisition

COORDINATION: Dave Stumpf, DDAI, 767-6266

DLA APPROVAL: *Oliver Calum*

FEB 13 1997

SUBJECT: Disposal of Munitions List Items in Possession of Defense Contractors, 5FJ-5024.02

RECOMMENDATION B.2: Recommend that the Director, Defense Logistics Agency, modify the existing demilitarization training program to provide clear instruction to plant clearance officers for the identification and control of munitions list items in the possession of Defense contractors.

DLA COMMENTS: Partially concur. The DoD Demilitarization Program Course is currently structured to address two distinct groups - inventory control point personnel and DCMC property management personnel. Lesson plans and content of instruction are different for each group. Current training for DCMC personnel has improved considerably during the last two years. Given the importance of demilitarization, we are striving to ensure continued improvement of the course in the future, and have created an informal team of DCMC property management personnel and the DoD Demilitarization course director in order to further enhance the course's relevance to the disposal of MLI and SLI from contractors' plants. It must be noted that until the proposed demilitarization policy for the DoD FAR Supplement is issued, the training cannot be specific in certain areas. Once the DFARS coverage is approved the policies contained therein will be disseminated to the students as part of this course, which should further improve students' understanding of demilitarization of contractor inventory. The course will continually be improved by increasing the clarity of guidance regarding all areas of demilitarization, including identification of MLI in the possession of defense contractors.

We have reviewed the student course critiques prepared by DCMC students who attended the course during the last two years and found that, with the exception of a few negative comments (less than 2 percent), the comments were extremely favorable. It must be noted that, as with any training curriculum, a course of instruction is in a constant state of evolution and improvement, and this course is no exception. Perhaps the individuals contacted by the Inspector General personnel who had negative views of the class had attended one of the first courses that was designed for DCMC personnel, or attended the course designed for inventory control point personnel.

DISPOSITION: Action is Considered complete

ACTION OFFICER: Paul Farley, AQOE

APPROVAL: Gary S. Thurber, Associate Director, Acquisition

COORDINATION: Dave Stumpf, DDAI, 767-6266

DLA APPROVAL: *Oliver E. Calhoun*

Audit Team Members

This report was prepared by the Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD.

F. Jay Lane
James L. Kornides
Stuart D. Dunnett
Tim F. Soltis
Mark Starinsky
Nancy Cipolla
Deborah Curry